Airlines Agreement (Termination) Bill 1990

Date Introduced: 16 May 1990
House: House of Representatives
Portfolio: Transport and Communications

Purpose

Background

Brief History of the Two Airline Policy

In 1945, the Australian National Airlines Commission was established by an Act of Parliament. It was the intention of the Government at that time that the Commission, operating as Trans-Australia Airlines (TAA) (later to become Australian Airlines), would have monopoly control of inter-State air transport. After a High Court challenge, the Commission was allowed to operate an airline but was denied monopoly control. TAA began operations in 1946 with its main competitor being Australian National Airways Pty. Ltd. (ANA) (later to become Ansett Airlines of Australia). Due to its modern aircraft fleet, but also benefiting from considerable Government assistance, TAA proved very competitive and by the late 1940s, ANA was making substantial losses.

The Menzies' Government was elected in 1949 and in 1951 the Prime Minister announced that steps would be taken to ensure that 'fair competition' prevailed between TAA and ANA. In 1952, due to mounting losses, ANA suggested that it would merge with TAA, creating virtually a monopoly airline. The Government refused to sanction such a move. The formulation of the subsequent two airlines policy was therefore intended to be a compromise between creating a monopoly while preventing 'wasteful competition' which, it was believed, could result from allowing more than two airlines to have access to a small market. The first Civil Aviation Agreement was negotiated between the Commonwealth, TAA and ANA in 1952 and successive Agreements in 1957, 1961, 1972, 1973, 1980 and 1981 have perpetuated the two airline policy.

The main features of the two airline policy arrangements contained in legislation to 1981 included:

- through Customs (Prohibited Imports) Regulations the import of aircraft into Australia was administered in such a way as to confine passenger trunk routes to the two major operators;
- the Airlines Equipment Act was used to restrict the aircraft capacity available to the two major operators;
- the 1951 Agreement required the two major operators to keep under review a range of matters including timetable, frequencies, stopping places, aircraft types, capacity, fares and freight rates, with a view to avoiding unnecessary overlapping of services and wasteful competition;
- provisions relating to ensuring that TAA as a government owned airline operated on a commercial basis and was able to compete with the privately owned airline (e.g. establishment of an annual dividend target for TAA);
- provisions providing for the Commonwealth to recover the costs of airport and airways facilities; and
provisions to ensure that the two major operators continued to provide rural services in certain circumstances, comply with curfew and keep under review the introduction of promotional fares.

In 1977, the Minister for Transport announced that a Review of Australia’s Domestic Air Transport Policy would be undertaken. The Review, published in 1979, concluded that a system whereby two operators in competition provide the national trunk network is the most suited to Australia at this time, but that changes should be made to allow for greater competition... The two domestic airlines have reached a stage in their development where they could withstand competition on some routes'. The Review also recommended that the two airline system should be monitored and reviewed at intervals of five years. Several of the Review recommendations were incorporated in an Airlines Agreement signed in September 1980. However, many groups expressed reservations about the terms of that Agreement, including that: the minimum life of the Agreement (ten years) was too long, especially if it appeared that further deregulation of the industry might become warranted; that no independent mechanism existed to prevent a possible 'rubber stamping' of any proposed fare changes; and that provisions relating to the operations and pricing of regional airlines on prescribed routes (especially prescribed routes linking trunk centres) were too restrictive. The 1980 agreement was supplanted in 1981 by a new Agreement which sought to accommodate the various criticisms listed above.

The 1981 Agreement deregulated freight and air mail services which at that time accounted for approximately 10% of the revenue of the two airlines. The 1981 Agreement also reaffirmed that only two operators should provide scheduled services on trunk routes, and which were for the first time comprehensively defined. Other operators were permitted to operate on prescribed routes which are intra-State and intra-Territory routes; routes between a regional centre and another place in Australia; routes over which the Minister has requested the major airlines to provide a passenger service and that service has not been satisfactorily provided; and routes over which an operator other than TAA or Ansett provided scheduled services as at 1 July 1980. The Agreement also allowed cargo operators and regional airlines to import turbo-jet aircraft. The Agreement continued the process of compulsory consultation between the airlines in matters relating to aircraft capacity and the setting of fares. The Agreement streamlined the existing process whereby the major airlines can withdraw from rural routes on which losses are being made. The Agreement defined the present role of Qantas as being the international carrier and TAA and Ansett as the domestic carriers. Each airline could provide services on behalf of any other Airline. Under the terms of the 1981 Agreement, the parties to the Agreement could, after a period of 5 years, give notice of termination of the Agreement, with the notice period being a further 3 years. The 8 years minimum duration period of the Agreement was designed to give security to the airlines which had just committed themselves to a large investment programme of aircraft purchases.

In March 1985, the Government commissioned an independent review of the Commonwealth’s role in the economic regulation of the aviation industry (the May Review). The Review, which was released in December 1986, was required to report to the Government on possible options for the future regulation of the aviation industry. The options put forward by the Review included:

- retention of the existing two airline policy;
- refining the existing system of administering the two-airline policy;
- removal of most Commonwealth fare and route entry controls but retaining aircraft import controls; and
- removal of all Commonwealth economic regulatory controls but retention of the existing safety regulatory framework.

The Review also addressed an extensive range of related issues including the international experience with airline deregulation, the safety implication of deregulation, air fare matters, the views of air travel consumers in Australia on the two airline policy and the
demand for domestic air travel. The findings of the Review included:

- widespread community opposition to the two airline policy;
- the high level of passenger dissatisfaction with fare levels and over perceptions of restricted competition and parallel services;
- market sharing arrangements guaranteed to the airlines under the present system discourage the two major operators from seeking out new markets and developing existing markets; and
- that the present national fare controls involve significant cost pooling across airline networks which differ greatly in route densities and operating costs with adverse economic efficiency implications.

On 5 June 1987, the then Minister for Aviation announced that the Commonwealth intended to give notice to end the two-airline policy. The Minister said that the policy had 'outlived its usefulness to the Australian public' and that it was 'unduly restrictive'. At the same time, the Minister stated that the Government's policy was to ensure that aviation was 'as efficient an industry as possible' and 'as available to as many Australians as possible'.

On 7 October 1987, the Government gave formal notice that it would terminate the two airline policy. The Governments stated objectives in bringing the two airline policy to an end include:

- "...to create an environment which will foster an increased responsiveness by airlines to consumer needs;
- a wider range of fares and types of services to provide enhanced travel opportunities;
- increased competition and pricing flexibility leading to greater economic efficiency in the industry; and
- a continuation of Australia's world renowned aviation safety record.'

The Governments stated means of achieving the above objectives is to adopt the broad thrust of option 5 proposed by the Review. The Government indicated that this means '...that the Government will, upon termination of the airlines agreement in October 1990, withdraw from the detailed economic regulation of four matters.

First, controls over the importation of aircraft will be removed. These controls have provided the threshold underpinning of the legislative and contractual arrangements which currently regulate the industry. Secondly, the detailed determination of the amount of passenger capacity that may be provided by each trunk airline, and each regional airline which uses jet aircraft larger than 30 seats, will cease. Thirdly, the Independent Air Fares Committee which currently sets all air fares will be abolished and the Commonwealth will withdraw from the determination of air fares. Fourthly, the existing constraints on the entry of new domestic operators to trunk routes will be removed.'

**Overseas Experiences of Deregulation**

The Governments decision to deregulate the domestic airline system comes some 10 years after comparable developments in the United States. More recently Canada, New Zealand, Japan and the European Community have taken steps towards deregulation of their domestic airline markets. Cheaper fares, a greater variety in the types, standards and frequency of services provided and greater incentives for existing and new participants to develop the domestic airline industry were benefits overseas policy makers expected to result from the increased opportunities for competition in a deregulated market. To a certain degree, an examination of whether the expectations of overseas policy makers have been fulfilled may provide an insight into whether the expectations of the Australian Government, which are basically the same as overseas policy makers, will be met. However, in assessing overseas experiences, it is important to recognise the difficulties of determining the applicability of those experiences to Australia. It has to be recognised that the Australian two airline policy has left an indelible mark on the structure and operations of the domestic airline industry which is unique to Australia and which will have an impact on the industry's performance in the post-deregulation period.
The United States: The United States Airline Deregulation Act 1978 initiated a staged deregulation of the US domestic airline industry. The Act removed restrictions on entry into the trunk airline routes, with the only condition on entry being a fitness test on the general economic and community standing of the entrant. The Act also introduced controls on mergers similar to those applicable to the business community in general and banned inter-airline agreements which involved capacity restrictions and fare fixing. Ten years after deregulation, the general consensus among industry analysts has been that the industry has become significantly more concentrated, with nearly all the main post-deregulation entrants having gone bankrupt or absorbed into one of the old-established operators. For example, between 1978 and 1988, 70% of the 200 operators (new and existing) serving the US market either failed or were absorbed into larger carriers. One of the early benefits of deregulation was a substantial decline in fare levels on most routes of any significance. It has been suggest by some analysts that the initial reduction in fare levels was largely achieved through the negotiation of more advantageous wage-conditions packages with the airline labor force and the deferral of aircraft replacement. However, over the past year there has been a general escalation of air fares. This has been attributed to the decline in the level of competition in the industry and as evidence of the airlines needing funds to replenish capital reserves to finance new equipment purchases. During 1988 US airfares rose by at least 11%, although on some routes, increases were as much as one third.

Canada: The deregulation of the Canadian domestic airline industry occurred between 1984 and 1988. The stated objectives of the Canadian Government for deregulation included: giving consumers a wider range of price-service options; to invigorate the industry and stimulate growth; to promote national integration; to improve airline efficiency; and to counter the seepage of Canadian traffic to US ports. Similar to Australia, the Canadian domestic airline system has been dominated by two domestic carriers, the Government owned Air Canada and the privately owned Canadian Pacific (now Canadian Airlines) with a large number of smaller regional carriers feeding the two major airlines. Prior to deregulation, many of the regional carriers had been absorbed into one of the two main carriers, Air Canada and Canadian Airlines. In the case of Canadian Pacific, this airline itself was absorbed into one of the major regional airlines, Pacific Western, the new merged group becoming known as Canadian Airlines. This process has continued since deregulation with most regional carriers now being either owned or in corporate alliances with one of the two trunk carriers. Wardair, the equivalent of Australia's East-West Airline, and Canada's cheap fare proponent has recently been absorbed into Canadian Airlines. Unlike with the American deregulation experience, Canadian deregulation has not produced a rush of new entrants into the domestic airline industry. However, despite the maintenance of a small number of carriers there has been considerable fare discounting. Basically, the outcome of Canadian deregulation has been the maintenance of a domestic two airline industry.

New Zealand: Deregulation of the domestic airline industry in New Zealand began in the mid 1980s. The entry of Ansett into the New Zealand domestic airline industry has been the most significant response to deregulation to date. Ansett has concentrated on the major trunk routes and has sought to gain a significant share of the domestic market by offering a substantially higher quality air transport service than that previously available from the other major domestic carrier, Air New Zealand. Ansett's action have draw responses from Air New Zealand in the form of service standard improvements and a discount fare strategy. Air New Zealand has been critical of the Australian Government's planned deregulation of the Australian domestic airline industry, claiming that the move strongly favoured Ansett and Australian Airlines, particularly in view of the long terminal leases negotiated with the latter and the long lead time provided to the two existing carriers to prepare for competition.
Main Provisions

Clause 2 provides that the Bill will have effect from 31 October 1990.

The Airlines Agreement Act 1981, Airlines Equipment Act 1958 and the Independent Air Fares Committee Act 1981 will be repealed by clause 3. The effect of the repeal of these Acts will be end the two airlines policy.

References

4. Ibid., p. 749.
5. Ibid.
7. Ibid., p. 6.
8. Ibid., pp. 6 and 7.

For further information, if required, contact the Economics and Commerce Group on 06 2772460.

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This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

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